



Comprehensive Tax Reform

North Carolina's Recent Experience

Robert Bowles, NC Department of Revenue

Ed McLenaghan, NC Office of State Budget & Management



Tax Reform: It's even more complicated than it looks.

The image shows a blackboard with several mathematical equations written in white chalk. The equations are related to probability distributions and tax reform. The most prominent equation is the derivative of the log-likelihood function with respect to the mean parameter a for a normal distribution:

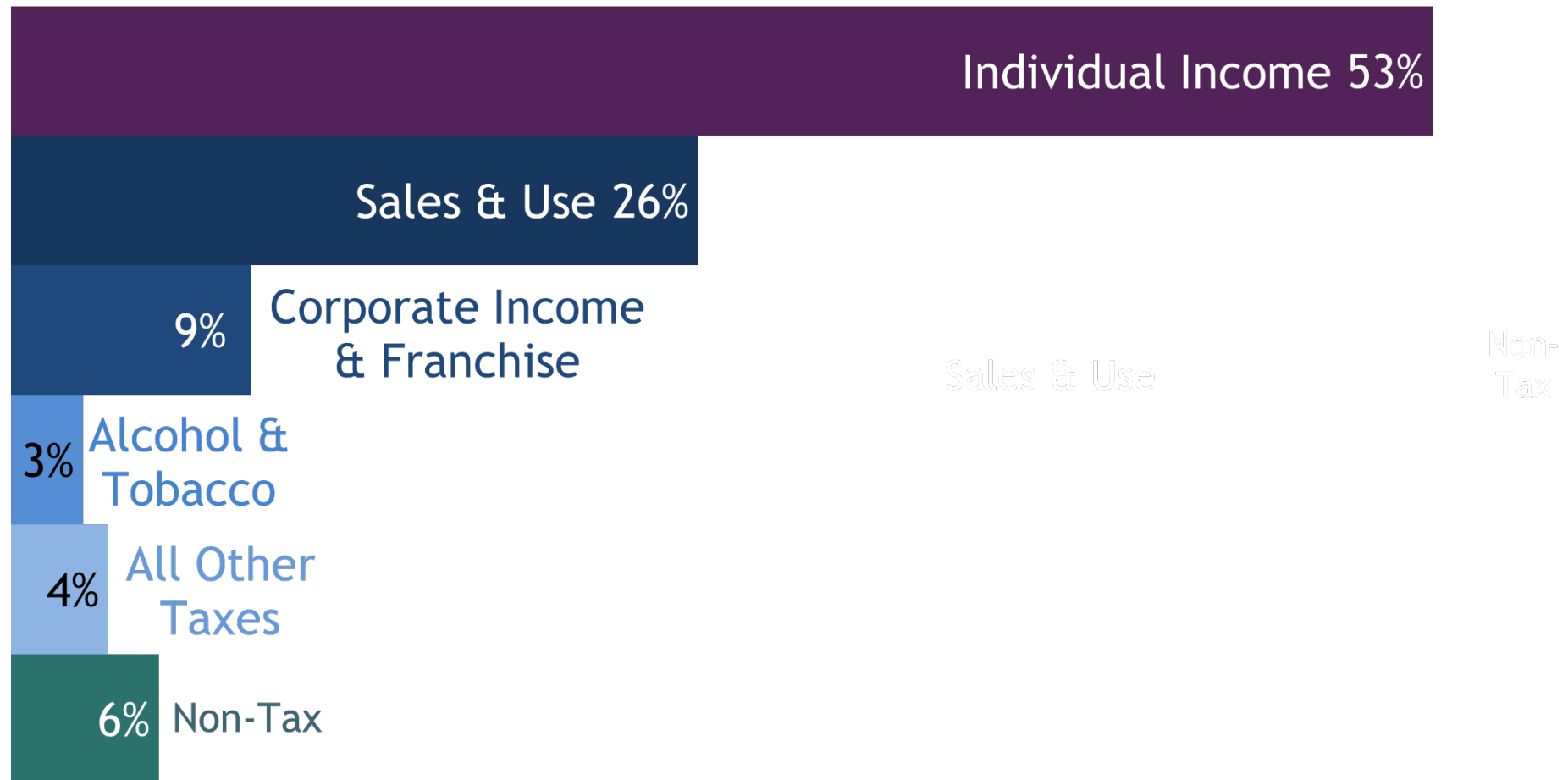
$$\frac{\partial}{\partial a} \ln f_{a, \sigma^2}(\xi_1) = \frac{(\xi_1 - a)}{\sigma^2} f_{a, \sigma^2}(\xi_1)$$

Other equations include the expectation of a function $T(x)$ with respect to a probability density function $f(x, \theta)$:

$$\int_{R_n} T(x) \cdot \frac{\partial}{\partial \theta} f(x, \theta) dx = M \left(T(\xi) \cdot \frac{\partial}{\partial \theta} \ln L(\xi, \theta) \right)$$
$$\int_{R_n} T(x) \cdot \left(\frac{\partial}{\partial \theta} \ln L(x, \theta) \right) \cdot f(x, \theta) dx = \int_{R_n} T(x) \cdot \left(\frac{\frac{\partial}{\partial \theta} f(x, \theta)}{f(x, \theta)} \right) \cdot f(x, \theta) dx$$
$$\frac{\partial}{\partial \theta} \int_{R_n} T(x) f(x, \theta) dx = \int_{R_n} \frac{\partial}{\partial \theta} T(x) f(x, \theta) dx$$

North Carolina's Tax System in 2013

Individual Income & Sales Taxes Comprise Vast Majority of Revenue



FY 2012-13 General Fund Revenues

Source: NC Department of Revenue data



Tax Reform Becomes Law July 2013

GOP has majority to update state's tax structure

Posted December 14, 2012

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MORE ON THIS

Closing tax 'loopholes' could be painful for all

By Mark Binker and Laura Leslie

RALEIGH, N.C. — As Sen. Bob Rucho sees it, taxes have a lot in common with the cholesterol floating about his body —

Cities could lose revenue under tax reform

Bob Rucho, Andrew Brock, Austin Allran

2013



@NC Capitol
House, Senate, governor reach tax deal
Realtors remain wary of NC tax reform

NC Capitol
McCrorry still open to dumping state income tax
Closing tax 'loopholes' could be painful for all
By Mark Binker
RALEIGH, N.C. — If that got nods from

GARNER CLEVELAND RECORD MAY 11, 2013 7:07 AM

Senate GOP debuts far-reaching tax overhaul

HIGHLIGHTS

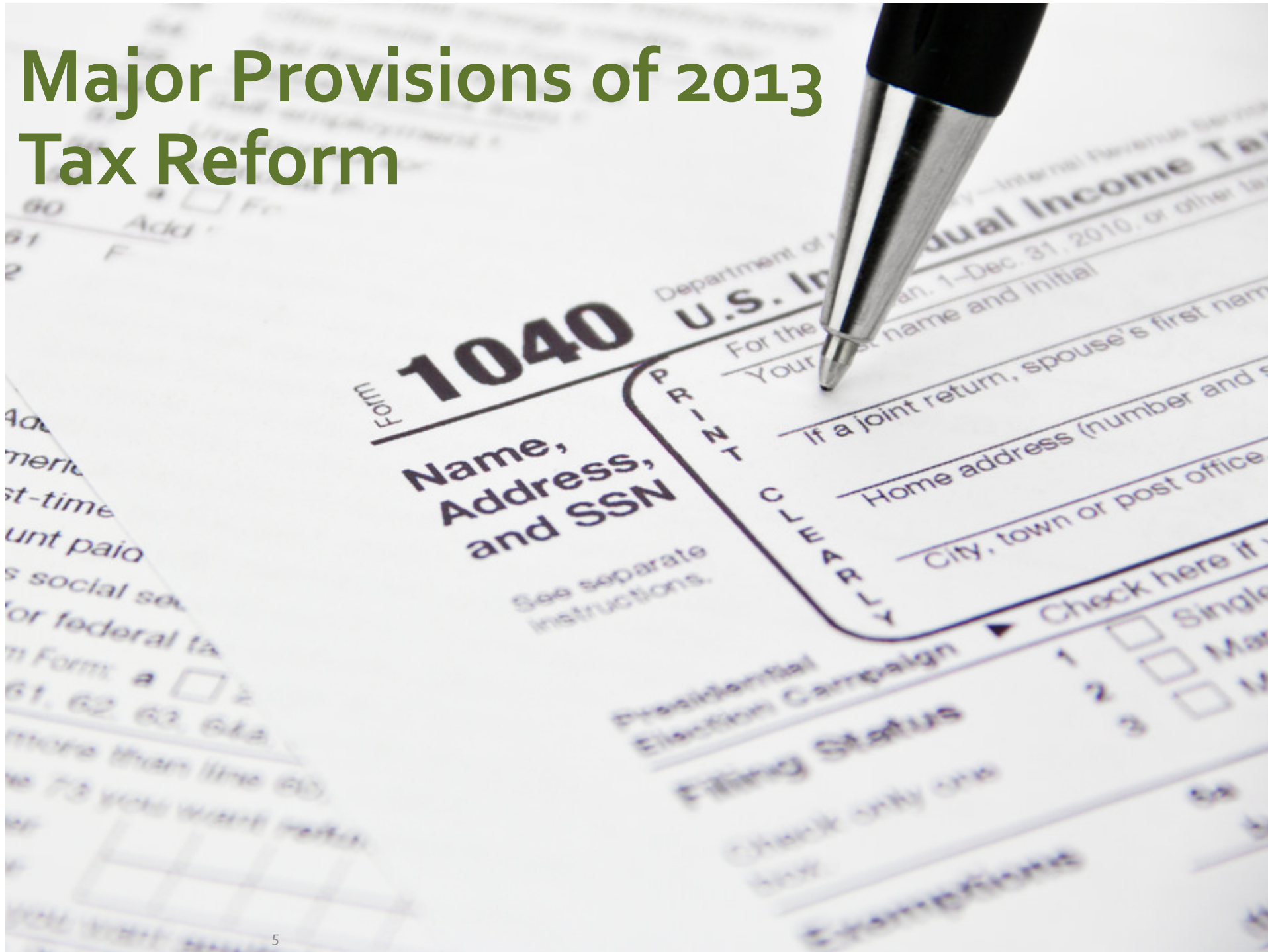
A much-anticipated income taxes in excise tax debut Tuesday in the

Tax reform bill passes NC House and Senate

INDUSTRY NEWS > HEALTH CARE

Is there hope for tax reform in NC? McCrorry seems doubtful

Major Provisions of 2013 Tax Reform



Individual Income Taxes

Tax Rates:

Graduated to flat

Deductions:

Bigger standard, fewer itemized
Business income deduction repealed

Exemptions:

Personal exemption & others repealed

Credits:

Several sunset, others repealed, one expanded



Consumption Taxes

Gross Receipts to Sales Tax:

Electricity, natural gas, live entertainment, and movies

Exemptions & Preferential Rates:

Several repealed, several extended

Base Expansions:

Admission charges, service contracts



Corporate Income & Other Taxes

Corporate Income Tax Rates:

Two certain rate cuts, two performance-based

Repeals:

Estate tax, earmark for school construction

Incentives:

Extension of R&D credit

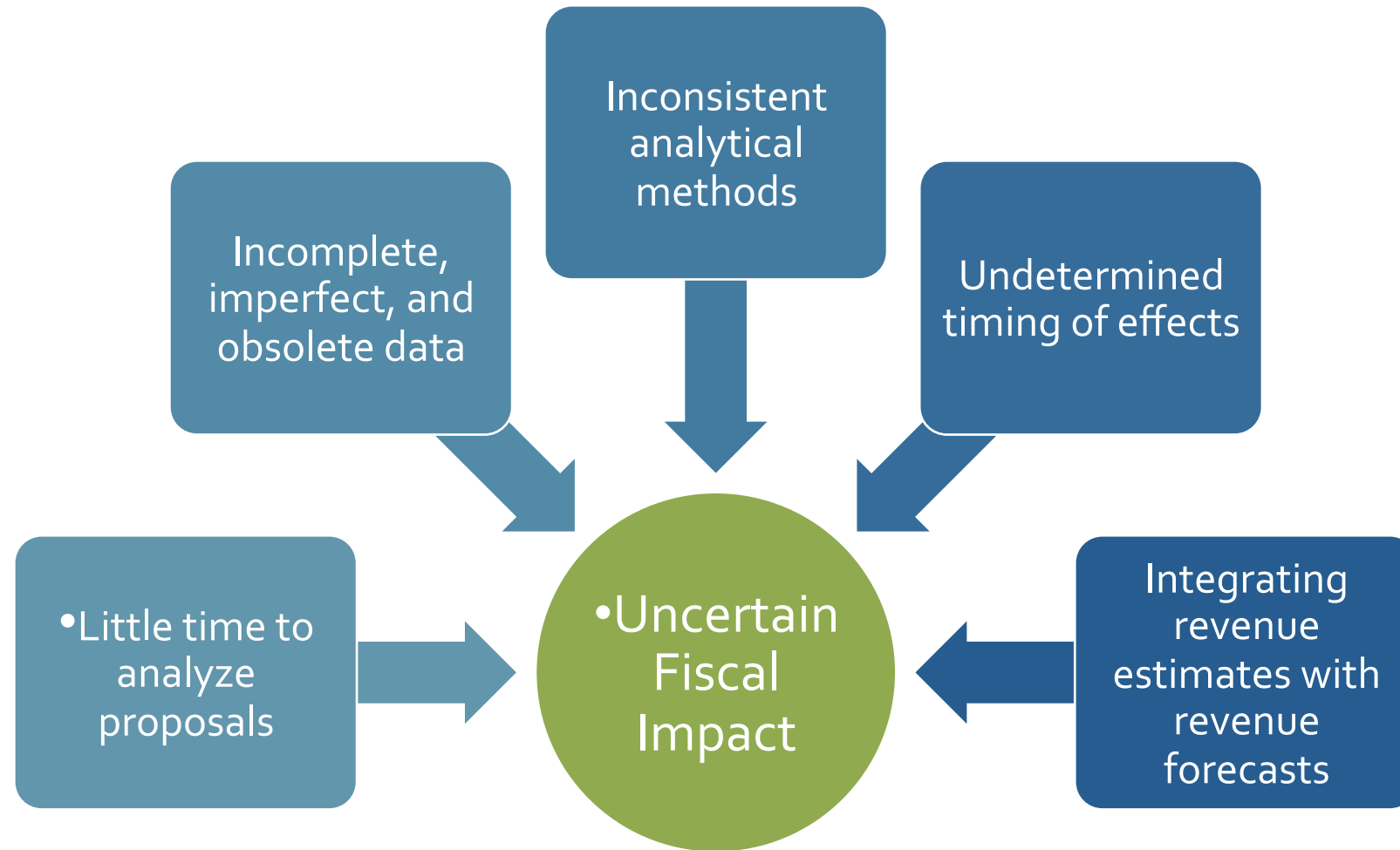
Sunset of major jobs & investment credits





Challenges Quantifying the Effects of Tax Reform

Quantifying Tax Reform: Challenges



Quantifying Tax Reform: Challenges

Fiscal Impact:

How Big?

Potential Error?

Revenue Forecast:

Timing of Impacts?

Assessing Impacts:

Tracking Revenues

Impact Error or Forecast Error?



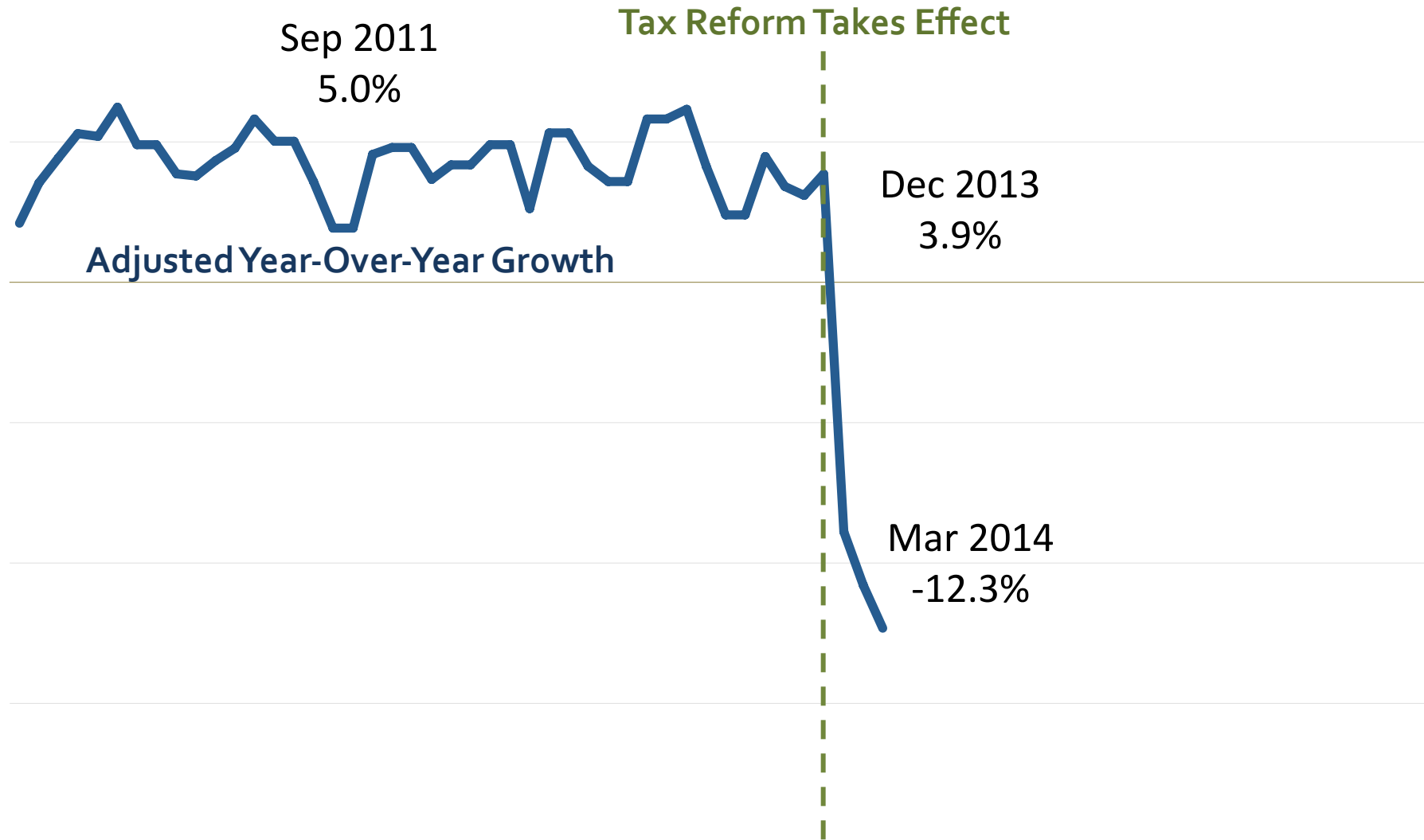
Revenue Trends After Tax Reform

Initial Impacts

Withholding plummets in first months of 2014



Withholding Drops Sharply After Tax Reform



Source: NC Department of Revenue data

Implementation of Tax Reform

Initial Impacts

Withholding plummets in first months of 2014

Negative April surprise

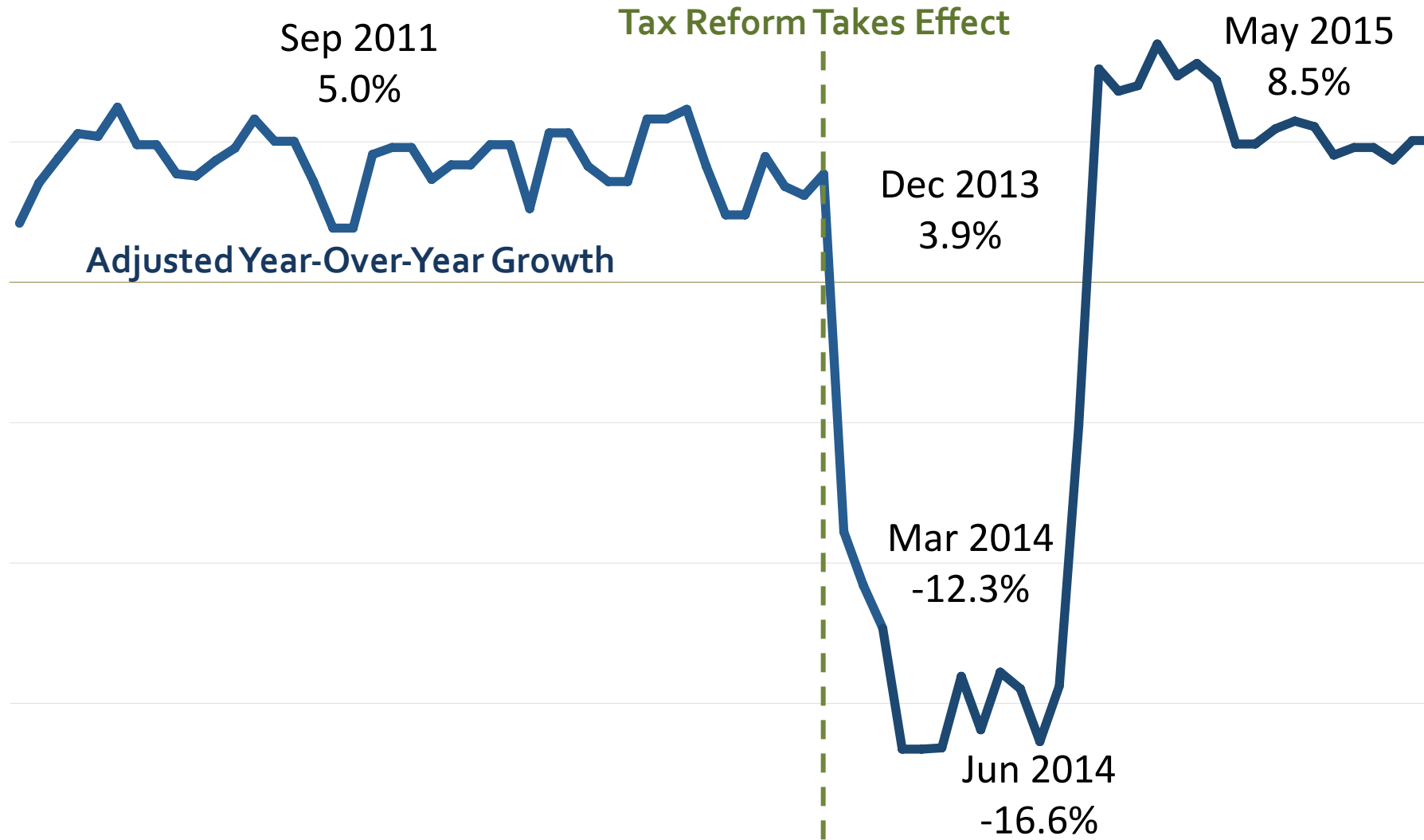
Downward revisions to forecasts

Withholding continues to disappoint through 2014

Big reversals in early 2015



Withholding Drops Sharply After Tax Reform



Source: NC Department of Revenue data

The Impacts of Tax Reform



Implementation of Tax Reform

Personal Income Tax:

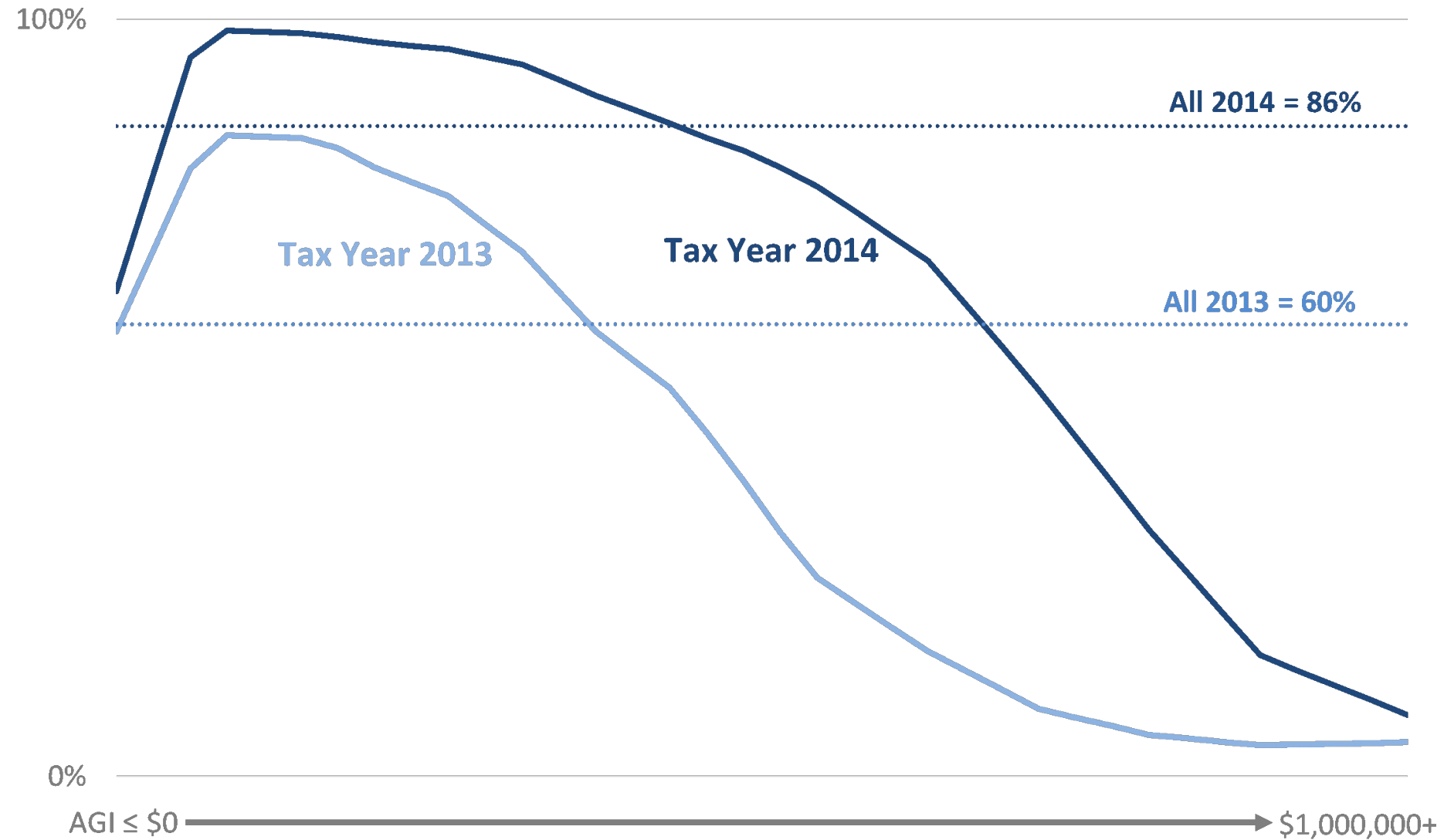
New Withholding Certificates & Tables
Simplified Tax Return & Instructions

Sales & Use Tax:

Multiple Implementation Dates
Timing Issues

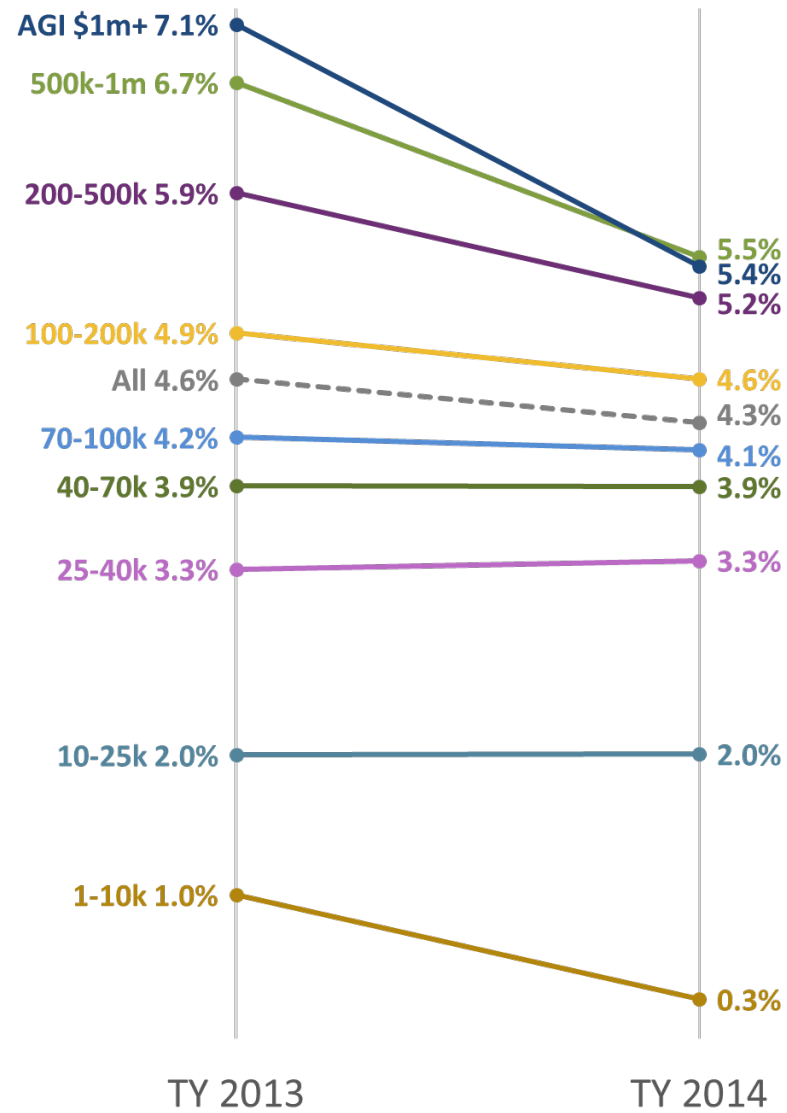


Many More Filers Claim Standard Deduction



Source: NC Department of Revenue data

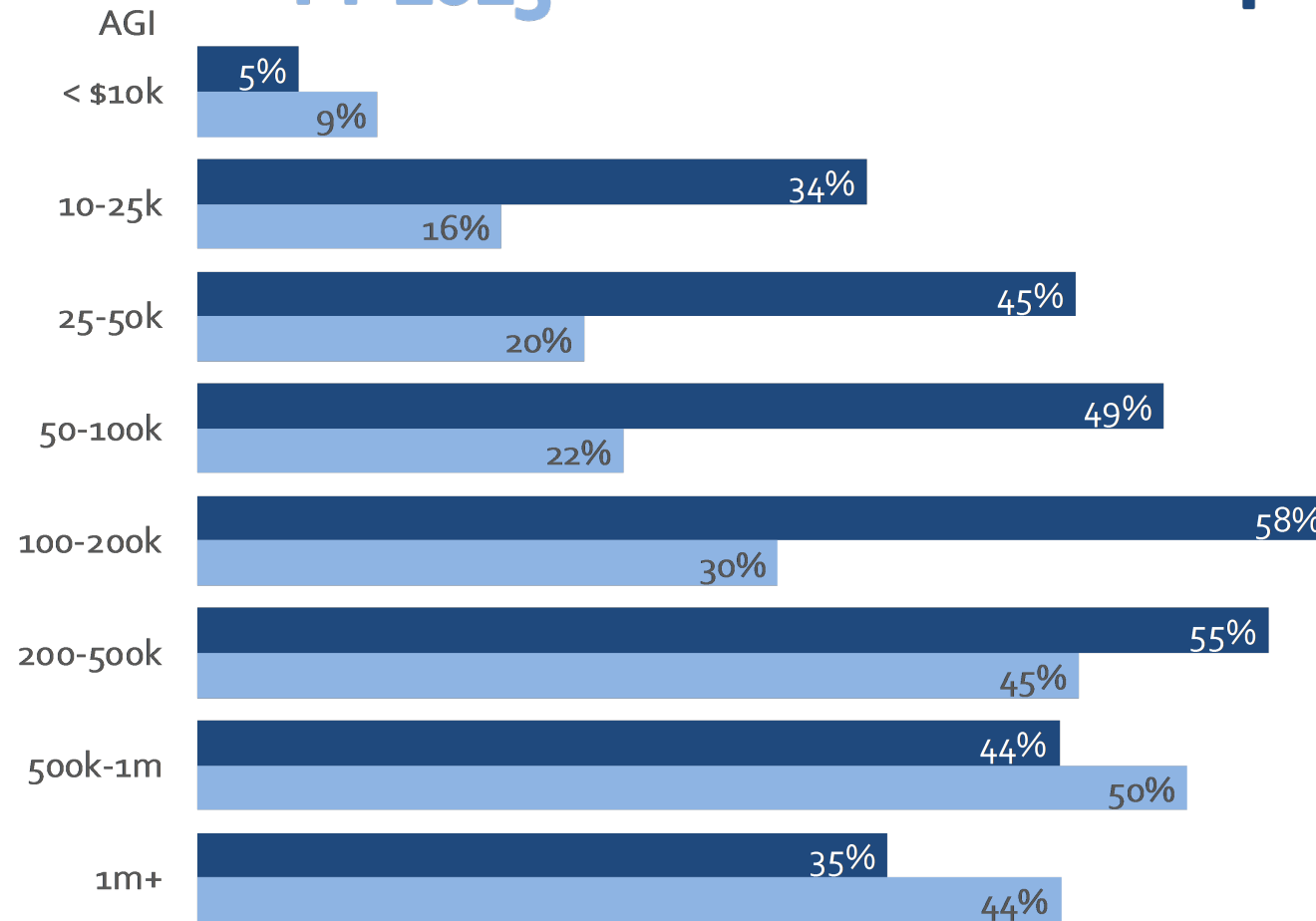
Effective Tax Rates Fall at Top & Bottom



Source: NC Department of Revenue data

Share of Filers With Balance Due Doubled

All Resident **19%** **TY 2013** → **38%** **TY 2014**



Source: NC Department of Revenue data

Impact of Tax Reform: Looking Back

Personal Income Tax:

- Many more filers claim standard deduction
- Fiscal impact at high end of range
- Biggest tax cuts at highest & lowest incomes

Sales & Use Tax:

- Likely underestimate of some fiscal impacts

Corporate Income Tax:

- Change in overpayments applied to estimated tax



Additional Rounds of Tax Reform

Personal Income Tax:

- Medical expenses

- Increases in standard deduction

- Higher withholding rate

- Further rate reduction

Corporate Taxes:

- Additional rate cuts

- Phase in sales-only apportionment

- Sunset of major credits



Additional Rounds of Tax Reform

Sales and Use Tax:

Two rounds of base expansions for repair, maintenance, and installation services
Adjust local distribution

Other Taxes:

Eliminate local privilege license taxes



Lessons for Other States

Ensure detailed, reliable data

Develop consensus on analytical methods

Coordinate across agencies and branches

Plan ahead for real-time evaluation



Appendices



Personal Income Taxes	2013	2014
Tax Rates	6.0% to 7.75%	5.8%
Standard Deduction	\$6,000 (MFJ); Additional blind/elderly deduction	\$15,000 (MFJ)
Itemized Deductions	Federal excluding state income and sales taxes	Charitable contributions; Real estate taxes and mortgage interest (capped at \$20,000)
Personal Exemptions	\$2,500 below \$100,000 AGI; \$2,000 otherwise (MFJ)	Repealed
Other Notable Deductions	\$50,000 business income deduction; \$2,000/\$4,000 retirement income deduction	Repealed
Credits	\$100 per child credit below \$100,000 AGI; Dependent care credit; Non-itemizer charitable credit; Many smaller credits	Sunset of EITC; Additional \$25 child credit for AGI below \$40,000 (MFJ); Eliminate dependent care credit, non-itemizer charitable credit, real-property donation credit, and others

Major Provisions of 2013 Tax Reforms

Consumption Taxes

Good/service	2013	2014
Electricity	3.0% sales tax; 3.22% gross receipts tax	7.0% state sales tax w/ local distribution
Natural gas	Tax dependent upon amount purchased	7.0% state sales tax w/ local distribution
Admission charges for live entertainment	3.0% gross receipts tax	Subject to state and local sales tax rates
Movies	1.0% gross receipts tax	Subject to state and local sales tax rates
Other Changes		
<ul style="list-style-type: none"> - Repealed exemptions: service contracts, food sold in college/university dining halls, sales tax holidays, and several others - Caps/thresholds: minimum receipts threshold for farming exemptions, \$45 million cap on sales tax refunds for nonprofits 		



Major Provisions of 2013 Tax Reforms

Corporate Income & Other Taxes

Provision	2013	2014	2015
Corporate Income Tax Rate	6.9%	6.0%	5.0%
Major Credits	Film, jobs, investment, low-income housing, renewables, historic rehabilitation, R&D	Film, low-income housing, renewables, historic rehabilitation, R&D	R&D, renewables

Other Changes

- Estate tax repealed retroactively to January 1, 2013
- Adopted automatic tax-revenue triggers to reduce CIT rate to 4% in 2016 and 3% in 2017 if total General Fund tax revenues exceeded a specified threshold
- Credit for renewable energy property sunset after 2015; Redesigned historic rehabilitation credit adopted for 2016
- Film credit replaced with a grant program in 2015
- Corporate income tax earmark for school construction repealed
- Extended sunset of business incentives for R&D, motorsports teams, and airlines
- Required studying additional changes, many of which later became law

